Commonwealth of Massachusetts
State Ethics Commission

One Ashburton Place, Room 619, Boston, MA, 02108
phone: 617-727-0060, fax: 617-723-5851

CONFLICT OF INTEREST OPINION
EC-FD-97-1

FACTS:

You ask whether you are required to report in your Statement of Financial Interests for the 1996 calendar year information about certain debts.

You are also engaged in the private practice of law. Several years ago, you joined a small law firm ("Firm"), a professional corporation,[1/] which has several other shareholder/lawyers.[2/] You own 10% of the Firm's outstanding shares of stock; you do not serve as a director or an officer of the Firm. You and the other shareholder/lawyers, as well as the Firm's associate lawyers and support staff, are employees of the Firm.

The Firm is indebted to an institutional lender ("Lender") as described below.[3/]

Term Loan. About a year before you joined the Firm, the Firm borrowed $150,000 from the Lender on a demand-loan basis to finance its expenditures for decorating, purchasing office equipment and furniture and otherwise outfitting its new offices for its occupancy. About six months after you joined the Firm, the Firm refinanced its earlier borrowing with the Lender as a 5-year loan ("Term Loan"). The Term Loan is evidenced by a promissory note, signed on behalf of the Firm by its president. (That note replaced the demand note evidencing the Firm's initial debt.) The interest rate is "Prime + 1.5%." The outstanding balance of the Term Loan is approximately $109,000.

Revolving Loan. On the same date as the Term Loan was consummated, the Firm entered into a loan agreement with the Lender for a line of credit of up to $300,000, increased more than a year later by amendment of the loan arrangements, to $500,000 ("Revolving Loan"). The proceeds of the Revolving Loan are used to finance the Firm's recoverable case costs made in connection with the Firm's practice (*e.g.*, expenditures for depositions, expert witnesses, medical examinations and consultants) and other of the Firm's ongoing expenses, including salaries (but never bonuses), during periods when the Firm's receipts are slow. The Revolving Loan is evidenced by a revolving demand promissory note, signed on behalf of the Firm by its president. The interest rate is "Prime + 1.5%," the same as the Term Loan. The outstanding balance of the Revolving Loan varies from time to time. When the Firm receives payments for its services (through case settlements or otherwise), it repays Loan principal; when the Firm requires more cash, it draws down the Loan.

You have informed us that the business terms of the Loans, including the interest rates, are typical of similar loans to similarly situated borrowers at the time the debts were incurred. As is customary in lending practice, the Lender required each of the shareholder/lawyers of the Firm to sign a guaranty ("Guaranty") of both Loans.[4/] Each Guaranty explicitly provides that it "is an absolute, unconditional and continuing guaranty of the full and punctual payment and performance of the Borrower . . . and is in no way conditioned upon any requirement that the [Lender] first attempt to collect any of the Obligations from the Borrower or any other party primarily or secondarily liable with respect thereto or resort to any security or other means of obtaining payment of any of the Obligations. . . ."

We shall review below the applicable financial disclosure reporting requirements.

Section 5(g) of G.L. c. 268B requires certain candidates for public office, public employees and public officials (collectively, AReporting Persons") to disclose in statements of financial interests ("SFIs") ten categories of information from the preceding calendar year. You are required to file an SFI. G.L. 268B, §§5(b) and 1(q). In particular, §5(g)(3) requires a Reporting Person to report:

> the name and address of each creditor to whom more than one thousand dollars was owed and the original amount, the amount outstanding, the terms of repayment, and the general nature of the security pledged for each such obligation except that the original amount and the amount outstanding need not be reported for a mortgage on the reporting person's primary residence; provided, however, that obligations arising out of retail installment transactions, educational loans, medical and dental expenses, debts incurred in the ordinary course of business, and any obligation to make alimony or support payments, shall not be reported; and provided, further, that such information need not be reported if the creditor is a relative of the reporting person within the third degree of consanguinity or affinity. (Emphasis added.)

To implement and administer the financial disclosure provisions of G.L. c. 268B, as required by §§3(a) and (b),[5/] the Commission has developed and published an SFI reporting form and accompanying instructions ("Instructions"). In relevant part, Section 15 (Other Creditor Information) of the 1996 Instructions requires a Reporting Person to disclose "each debt, loan, or other liability in excess of $1,000 owed by" the Reporting Person to a creditor, debt of a corporation in which the Reporting Person owns 10% or more of the stock and debt guaranteed by the Reporting Person unless any of the foregoing is a debt incurred in the ordinary course of business.

QUESTION:

You ask whether the Term Loan and the Revolving Loan or either Loan may be excluded from reporting in your 1996 SFI as a debt incurred in the ordinary course of business of the Firm.

ANSWER:

The Term Loan and the Revolving Loan were debts incurred in the ordinary course of business of the Firm. Therefore, you are not required to report either Loan in your 1996 SFI.

DISCUSSION:

As a guarantor of the Loans and also as the owner of 10% of the Firm's stock, you are required to report each Loan in your 1996 SFI unless the subject Loan constitutes "debt incurred in the ordinary course of business" ("OCB debt"). If either Loan constitutes OCB debt, you need not report such Loan in your 1996 SFI. Otherwise, you must report such Loan.

A. Overview

In *EC-FD-94-1*, we wrote that when construing statutory language, we begin with the premise that the

> intent of the legislature is to be determined primarily from the words of the statute given their natural import in common and approved usage, and with reference to the conditions existing at the time of enactment. This intent is discerned from the ordinary meaning of the words in a statute considered in the context of the objective which the law seeks to fulfill. . . .

citing *Int'l. Organization of Masters, etc. v. Woods Hole, Martha's Vineyard & Nantucket Steamship Authority*, 392 Mass. 811, 813 (1984); *O'Brien v. Director of DES*, 393 Mass. 482, 487-488 (1984). *See also*, G.L. c. 4, §6, cl. third.

G.L. c. 268B provides no definition or other helpful guidance about what constitutes OCB debt. Thus, we refer to dictionary definitions of "ordinary," "extraordinary," and "ordinary course of business" for the "plain meaning" of the phrase "ordinary course of business."

> "`Ordinary' - occurring or encountered in the usual course of events : not uncommon or exceptional : not remarkable : ROUTINE, NORMAL."

> "`Extraordinary' - . . . going beyond what is usual, regular, common or customary"

Webster's Third New International Dictionary (unabridged 1986).

"`Ordinary course of business' - The transaction of business according to the usages and customs of the commercial world generally or of the particular community or (in some cases) of the particular individual whose acts are under consideration. . . ."

Black's Law Dictionary (5th ed. 1979).

B. Application to the Loans

Generally, the determination of whether a business debt is in the "ordinary course" will depend on the nature, type and size of the subject business. What may be ordinary for a large business may be extraordinary for a small one. For example, a debt incurred by a large, well-capitalized law firm to acquire real property (land, a building or a condominium unit) for its offices could be "in the ordinary course" while such a debt transaction would likely be extraordinary (unusual and not "of a kind to be expected in the normal course of events") for a small, under-capitalized law firm.

"Even though the concept of ordinary course is not new to the law and even though a wide array of transactions could be identified as clearly within the ordinary course, the margin between what is ordinary course and what is not is quite ragged and hard to distinguish." *Bankruptcy Practitioner Series*, West Publishing Co. (1992), §4-2. To assess the "ordinariness" of a transaction in which debt is incurred, we may look at the transaction in light of the factors referred to in the *Black's Law Dictionary* definition quoted above to determine (i) whether the debt is ordinary by comparison to debt incurred by businesses similar to the debtor's (an external focus) and (ii) whether the debt is ordinary for the debtor in particular (an internal focus).[6/]

We shall analyze the Loans in light of those principles and the overview above.

Revolving Loan

Lines of credit, such as the Revolving Loan, are typically used by law firms "to support the short-term borrowing needs of the firm and are repaid through the conversion of work-in-process to accounts receivable to cash." David A. Rountree, "Banking Issues to Consider in Starting a Law Practice," *How to Start a Law Practice* (MCLE, 95-18.11), p. 121, Library of Congress Card No. 9576395. The Firm's use of the Revolving Loan reflects that practice. During "slow" receipt periods, the Firm draws down on the Revolving Loan to finance its day-to-day operations, such as the Firm's on-going expenses for recoverable case costs and salaries.[7/] The Firm repays Loan principal when it receives payments for its professional services.

As the Revolving Loan debt was incurred by the Firm to finance the Firm's day-to-day business operations and appears to be "of the kind to be expected in the normal course of events," not extraordinary ("going beyond what is usual, regular, common or customary") in any sense of the term, we conclude that the Revolving Loan constitutes debt incurred in the ordinary course of business of the Firm and that you are, therefore, not required to report that Loan in your 1996 SFI.

Term Loan

The above-cited article on banking issues states that "[t]erm loans (typically with maturities of two to five years) are appropriate for financing the purchase of fixed assets (furniture, fixtures and equipment) and are repaid through the earnings of the [law] firm." *Id.* at 121. The Term Loan debt was incurred by the Firm for just such purposes.[8/] The Firm has been in existence for some years and used the Loan proceeds to refinance its earlier expenditures and financing incurred (before you joined the Firm) to decorate, purchase office equipment and furnishings and otherwise outfit its new offices for its continued operation as a law firm. Such acquisition, financing and refinancing by the Firm - a going concern - upon typical business terms seems to us to be in the ordinary course of business of the Firm.

Furthermore, when assessing the Term Loan transaction in light of the external and internal focus described above, we find that a borrowing to finance or refinance the "outfitting" of new offices for occupancy by an existing law firm is not "uncommon or exceptional" and does not go beyond what is Ausual, regular, common or customary" for law firms generally and that such a borrowing seems ordinary for the Firm in particular. In sum,

our conclusion is that the Term Loan constitutes debt incurred in the ordinary course of business of the Firm and that you are, therefore, not required to report that Loan in your 1996 SFI.

DATE AUTHORIZED: October 16, 1997

[1/]Our description of the Firm is based entirely on records filed with the Secretary of the Commonwealth and information you have provided to us through your legal counsel.

[2/]The Firm was formed more than 15 years ago.

[3/]Our description of the Loans is based entirely on information and materials you have provided to us through your legal counsel.

[4/]Lenders typically require personal guarantees of the partners or members of borrower-law firms, other than large, well-capitalized firms. David A. Rountree, "Banking Issues to Consider in Starting a Law Practice," *How to Start a Law Practice* (MCLE, 95-18.11), Library of Congress Card No. 9576395.

[5/]These sections of the Commission's enabling legislation require the Commission to prescribe and publish rules and regulations to carry out the purposes of G.L. c. 268B and to prepare and publish forms for the required financial disclosure reports.

[6/]Such an analysis has been used in the bankruptcy/reorganization context to assess the "ordinariness" of certain business transactions. Collier, *Lending Institutions and the Bankruptcy Code* (1996), & 4.04[3], n. 9, citing *In re Waterfront Cos.*, 56 B.R. 31 (B. Ct. D. Minn. 1985); *see also, In re Johns-Manville Corp*., 60 B.R. 612 (B. Ct. S.D.N.Y. 1986). That is not to suggest that what is "in the ordinary course of business" in a bankruptcy or reorganization situation is or should be determinative of what is "in the ordinary course of business" in non-distress debtor/creditor business transactions such as the Loans.

[7/]Other such expenses might be for rent, utilities, insurance premiums, supplies, library and equipment maintenance, training and bar memberships.

[8/]We note that a debt need not be incurred at regular intervals to constitute OCB debt. A debt that is incurred only once or infrequently by the debtor may constitute OCB debt if it can otherwise be characterized as ordinary, as discussed above.